The Governor's 2023 Budget Proposal: Last Chance for a Lasting Legacy

MassBudget Staff

Governor Baker submitted his last state budget as Governor of the Commonwealth last week, and this Fiscal Year (FY) 2023 budget is not all that it might seem on the surface. The Governor describes this budget as one that "prepares Massachusetts for the future," but it does not present a bold vision. At a glance, his proposed budget the accompanying tax proposals:

- Fail to address the deep and underlying inequities across the state revealed during the pandemic;
- Do not tackle the statewide crisis for publicly-funded care workers that will have a long-lasting impact especially on the state's children, elders, and persons with disabilities; and
- Propose tax cuts most of which would in fact favor high-income filers, despite the fact that the headlines focused on his smaller proposals that would help lower-income filers.

It is also important to view the state budget in the context of declining federal COVID relief dollars. Massachusetts received more than $115 billion in the form of direct payments to individuals, support for businesses and organizations, and grants to state agencies and community groups. All of this federal support has put money in people's pockets and in turn buoyed our economy and helped boost the amount of taxes coming into the state's coffers. But much of this federal money is temporary and the related tax surplus is also likely temporary. It is unwise to assume that the state has more revenue than it needs based on temporary pandemic relief, meaning this is not the time for deep and lasting tax cuts in the Governor's FY 2023 budget proposal.

The Governor did propose some important new investments along with several proposed tax breaks that would help low- and middle-income households. But overall, this budget continues to fall short in meeting significant needs across the Commonwealth, and it offers its most generous tax breaks to many of the state's wealthiest residents—the people who need them least. These kinds of upside-down proposals make our state's widening income inequality worse, not better.

Balancing the Budget and Tax Proposals

How a state budget proposal achieves its balance between spending and revenues provides important information about underlying values. When there are reductions in revenue, they must be balanced by reductions in spending. Across the budget overall, the Governor's funding proposals barely keep pace with inflation. This can lead to program and service cuts when funding does not keep up with rising costs and the need to increase wages for state-funded workers.

The Governor's FY 2023 state budget proposes several changes to the state's tax code, including two that primarily benefit the state's highest-income residents and that together will cost the state $348 million in lost revenue annually. Unfortunately, these measures would cut revenue at a time when the state needs it to sustain investments beyond the pandemic as it moves towards an equitable recovery.

The first proposal reduces the state tax rate on short-term capital gains, cutting the current rate from 12 percent to 5 percent which will cost the Commonwealth $117 million and directly affect 150,000 people. A short-term capital gain is the profit made from selling an investment (like a stock) that has been held for less than a year. Approximately 80 percent of the tax break will go into the pockets of the state's highest income 1 percent of residents, while only about 3 percent will go to middle- or low-income people – representing the bottom 80 percent of households.

A second proposed tax change would modify the state tax on estates and would cost Massachusetts an estimated $231 million in revenue each year. Estate taxes are paid by an estate of a high-wealth individual at the time of death. The current estate tax threshold is $1 million, and estates below the million-dollar threshold are fully exempt from the tax. Estates above the threshold currently pay a tax on the full value of their estate, which is sometimes referred to as the "estate tax cliff." The Governor's proposal would increase the threshold to $2 million and change the structure of the tax so that it would apply only to the value of the estate above the threshold.

The Governor's proposal is an expensive tax break for the Commonwealth, as the state would lose hundreds of millions of dollars every year, and this money would be going back to the holders of these large estates who are some of the wealthiest families in the Commonwealth. **Any reduction to the estate tax by definition only benefits people who hold enough wealth (above $1 million currently) when they die that they are subject to an estate tax.** The Massachusetts estate tax is graduated, and under current law the rates rise from 4 percent of the value of estates of about $1 million to 16 percent for larger estate amounts.

- According to a recent analysis prepared by the Mass. Department of Revenue, there were 4,274 estates taxed in Massachusetts in 2017, a year in which the state registered close to 58,900 deaths. **Based on those figures, almost two-thirds of the value of the Governor's proposed estate tax break would go to the wealthiest two-fifths of the estates that are currently subject to tax.** These are estates valued over about $2.25 million.
- At the same time, the Governor's proposed estate tax change is not needed to eliminate one of the Governor's concerns with the current estate tax. **The so-called estate tax cliff could be eliminated with only a few million dollars of total revenue loss by instead creating a small tax credit just above the tax threshold that phases out quickly (for example as set out in H.3038/S.1884).** This would ensure that estates right above the threshold would pay less tax without providing large tax benefits to the biggest estates.

In addition to his proposals for capital gains and estate taxation, the Governor's budget proposal would also make the tax system more regressive because it does not include language further delaying the FY 2023 implementation of a tax deduction for **charitable contributions.**

- Large contributors generally already receive a federal tax break on their contributions. **Slightly more than half of the value of tax breaks from a state charitable tax deduction going into effect in**

FY 2023 would go to the tiny minority of tax filers with income over $1 million. Once in effect, the full year's revenue loss would be about $300 million annually.

- The benefit of this tax break would flow mostly to taxpayers whose incomes are so large that they choose not to take a standard deduction and choose instead to itemize their deductions. **If Massachusetts lawmakers want to establish a state charitable deduction that would be targeted to middle- and lower-income taxpayers, they could do so by making the state deduction available only to tax filers that were not also claiming the deduction on their federal taxes.** This would also retain most of the revenue that would otherwise be lost to this tax cut.

In contrast to these three tax breaks for the state's highest-income households, the Governor proposes other tax changes that would spread benefits across all income levels:

- **A proposal to double the value of the refundable dependent tax credit for families caring for dependents such as children or elders would cost the state a total of about $167 million each year.**
- **A proposal to increase the maximum allowable renters' deduction from $3,000 to $5,000 would provide tax benefits to renters at all income levels.** Because low-income tax filers are more likely to rent than upper-income tax filers they would benefit from this increase in the deduction amount. But this is not a refundable credit, so renters may be less able to apply this additional deduction against other taxable income.

Finally, there are two tax proposals in the Governor's budget that are truly targeted to low-income tax filers, though their total benefits are a small fraction of the tax cuts proposed, especially in contrast to the tax breaks that would chiefly benefit high-income filers:

- First, the Governor **proposes a $41 million tax break that aligns the state's income threshold "no tax status" with the higher federal levels, which would provide an average benefit of $175 for low- and moderate-income filers.** The total value of this tax break is not larger because many low-income people currently receive a refund and will continue to file income taxes to collect that check.
- Second, the Governor proposes **doubling the value of the refundable senior circuit breaker credit for low- and moderate-income elders who have especially high housing costs.** This change would cost the state an additional $67 million annually in forgone revenue.

The budget counts on approximately $50 million in revenue from assorted tax settlements and judgments over the course of the year. The Governor also proposes various changes to the income tax code that would bring the state into conformity with the federal code. The intent of this change is to simplify tax filing and would bring in about $27 million in additional revenue.

FY 2023 BUDGET REVENUE INITIATIVES ($ millions)	
TAX REVENUES	
Lowering the Tax Rate on Short-Term Capital Gains	(117)

Reducing the Number of Households Subject to the Estate Tax	(231)
Doubling the Child Care & Dependent Tax Credit	(167)
Increasing the Rental Deduction	(77)
Increasing Threshold for No Tax Status to Align with Federal Threshold	(41)
Doubling the Senior Circuit Breaker Credit	(60)
Tax-Related Settlements and Judgments	50
Federal Conformity and Other Statutory Updates	27
TOTAL	(616)

Non-Tax Revenue Proposals

The Governor's budget includes proposals that would end the practice of **charging fees to individuals convicted of crimes as part of their parole or probation which results in an estimated $4 million less in fees**. These individuals and their families often face financial struggles that are compounded by these fees and which make it more difficult to transition successfully from incarceration. Several of his other proposals would bring in new or additional non-tax revenues to balance the budget including:

- **Counting on $35 million from expanded sports betting** as he has in several prior years;
- **Expanding access to the state's lottery** by allowing purchases by debit card;
- **Expanding the ability of the state's MassHealth program to negotiate rebate agreements** directly with manufacturers for additional medications and other products.

As has been the case for many years, the budget continues to postpone a 2012 statutory requirement that the revenue received each year from the **Master Tobacco Settlement be used to support health insurance costs for retired state employees**. Starting in FY 2022, the full value of that funding (more than $250 million) should be used for that purpose. The Governor proposes using only $25 million of the total.

One of the largest changes to non-tax revenue in the FY 2023 budget is a dramatic anticipated drop in the amount of federal revenue coming to Massachusetts. This is primarily a result in an expected end to pandemic-related increased reimbursement for the state's Medicaid program (MassHealth). See below for further discussion.

Housing Proposals

While some of the previously mentioned tax changes proposed in the Governor's budget would help some low-income renters with their housing costs, on the spending side the Governor's budget falls quite short.

The Governor's FY 2023 housing budget represents a case study in the interplay between community need, new federal funding, and ongoing state support. Prior to the pandemic the need for rental assistance far outstripped the resources available in the budget. Programs like the **Massachusetts Rental Voucher Program (MRVP) and Rental Assistance for Families in Transition (RAFT)** were chronically underfunded and not always well-suited to meet the needs of people across the Commonwealth struggling to find and stay in affordable rental housing.

The Governor's budget proposal includes an increase of $58 million over FY 2022 funding for the RAFT program and funding for MRVP that does not even keep up with inflation. However, the Governor's Eviction Diversion Initiative spent close to $50 million *in just one month* in new federal rental assistance funding to meet the growing need for rental assistance. These federal dollars have been critical during the pandemic to help fill the substantial unmet need in programs such as RAFT and MRVP, but the federal funding will likely soon go away. Given the need for rental assistance unearthed during the pandemic, the Governor's proposed spending will not likely come close to meeting post-pandemic need. Moreover, the federal funding has been more flexible in several important ways than similar state programs and consequently have been better able to assist families and individuals.

Transportation Proposals

The Governor's budget proposal brings state aid to the MBTA back to $187 million, the level where it stood before FY 2018. Adjusted for inflation, Governor's proposal stands 13 percent below its FY 2017 level.

Meanwhile, the Governor proposes holding the **Regional Transit Authorities (RTAs)** level-funded at $94 million, the same amount as they received in FY 2021 and FY 2022. In effect, this is a cut in state funding during this period of relatively high inflation, leaving the annual budget support to fall further behind as the costs of fuel, paying bus drivers, and other expenses have grown briskly. While it is true that the RTAs have been receiving extraordinary sums of federal support, the Governor's level-funded budget sets up the RTAs for a funding cliff when federal support runs out.

Education Proposals

The Governor's FY 2023 budget proposal contains the funding for Chapter 70 school aid and grant programs connected to implementing the Student Opportunity Act (SOA). **Implementation of this law, passed in 2019, was delayed by one year, so FY 2023 is the second year of what is now a six-year funding schedule. The Governor's proposal ($591 million or 10 percent above FY 2022) represents the planned increase for the second year.** This funding should especially help districts serving more low-income students continue to sustain some of the important educational services and programs that have been initiated with new one-time federal funding.

While the proposal contains strong overall increases to support SOA implementation, the Governor did not fully fund charter school reimbursements by FY 2023, as intended within SOA. **Instead, the proposal would leave us a year behind on this pledge, with districts receiving $24 million less overall than they would have received had this program received full funding.**

The Governor's budget proposal for early education and care, on the other hand, represents a cut of over $131 million (14 percent) from current year funding. This dramatic decrease in state funding is an even larger drop when considering the amount of one-time federal COVID relief dollars currently supporting early education.

The shortage of care for the state's youngest residents has created a crisis for families across the Commonwealth. The Governor's proposed level of state investment cannot adequately address the ongoing crisis in our early education system, and the wider harm that this creates for our economy, working families, early educators, and especially our children. The Governor notes that he plans soon to file legislation for further funding for early education, but if this is funding from one-time federal dollars rather than ongoing and sustainable state funding, it only postpones addressing the root causes of the shortage in care.

MassHealth and related proposals

The Governor's budget reduces funding for the MassHealth program from an estimated spending total in FY 2022 of $19.67 billion to $17.81 billion in FY 2023. MassHealth is only partially paid for by state dollars, so the "net" cost to the state of the Governor's proposal (that is, the total state MassHealth program budget less the amount of federal reimbursement the state will receive to help pay for it) is about $8.82 billion.

This budget reduction is primarily due to the assumption that the national public health emergency—in place since January 2020—will likely end by June 30, 2022. During the public health emergency there have been several important changes that have had a significant impact on the state's Medicaid program (MassHealth). If a state agreed to protect Medicaid recipients from losing coverage during the pandemic based on changes in their income or based on failure to return renewal application forms, the state would receive an additional 6.2 percentage point reimbursement from the federal government for the duration of the emergency. (For a deeper discussion of these details in Massachusetts, see What is the Actual State Cost of MassHealth in State Fiscal Year 2022.)

Over the course of the pandemic, the Administration has counted on as much as $2.6 billion from this enhanced federal Medicaid reimbursement to help the state pay for its MassHealth costs. At the same time, because of what is known as this "continuous coverage" in enrollment, participation in the MassHealth program has grown from about 1.7 million people to over 2 million.

With an anticipated end of the public health emergency, the Governor's budget counts on both a gradual reduction in MassHealth enrollment to closer to pre-pandemic levels as well as the discontinuation of the enhanced federal reimbursement revenue.

One other notable change in the MassHealth program is that the Governor also includes an increase of $21 million in funding to increase the eligibility threshold for the Medicare Savings Program from 165% of the federal poverty level to 200%. The Governor expects that this change could benefit about 34,000 low-income elders and persons with disabilities. The Medicare Savings Program helps eligible people pay their Medicare Part B premiums and out-of-pocket costs. The Administration also assumes that this program expansion would save some money for the state's Prescription Advantage program and the Health Safety Net.